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TO RUEHC/SECSTATE WASHDC PRIORITY 9512
INFO RUEHBR/AMEMBASSY BRASILIA
RUEHRI/AMCONSUL RIO DE JANEIRO 4769
RUEHSO/AMCONSUL SAO PAULO 0374
RUEHRG/AMCONSUL RECIFE 6940
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SUBJECT: BRAZIL: U.S. TREASURY SECRETARY PAULSON MEETING WITH FINANCE MINISTER MANTEGA

¶1. (SBU) Summary: During their July 11 Brasilia meeting, U.S. Treasury Secretary Paulson and Brazilian Finance Minister Mantega discussed recent Brazilian economic performance, recent U.S. economic performance and the importance of promoting reform at the International Monetary Fund - including the selection of a new leader to replace Rodrigo de Rato. Mantega noted Brazil's current strong economic performance and said that Brazil's macroeconomic fundamentals are in excellent condition. Brazil still faces key challenges, including infrastructure and an overvalued exchange rate, which along with "unfair" Chinese currency regime, is causing problems for some Brazilian sectors. Secretary Paulson highlighted the importance of concluding a bilateral tax treaty and stated that he believes the highest trade policy priority for both countries should be the conclusion of a successful, multilateral Doha agreement. Both officials agreed that the IMF should become more representative of the global economy and should adapt to reflect the growth of countries whose economic importance is increasing. Secretary Paulson noted the USG will support the candidate the

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European Union favors to lead the IMF following the departure of Rodrigo de Rato. End Summary.

¶2. (SBU) Mantega highlighted strong current economic trends: Economic growth has recently accelerated; Brazil's trade surplus (\$40 billion forecast for FY 2007) remains strong; inflation is slightly below target (4.5% annualized); Brazil's recent primary surplus performance (equivalent to 4.3% of GDP) has exceeded the start-of-year fiscal target; and, interest rates are expected to continue to decline, helping to stimulate credit growth. With Brazil's improved outlook, Mantega opined that it is now possible for investors to "make a bet on Brazil's future."

¶3. (SBU) Mantega pointed to weak infrastructure and an overvalued exchange rate as two important challenges facing the country. He indicated that key infrastructure priorities should include improving airports and road transportation networks and explained that Brazil's strong economic performance and its rising living standards are creating new pressures and demands for additional infrastructure as a growing number of Brazilians now want to travel. On currency appreciation, Mantega said that Brazil's currency is

now overvalued, which, coupled with an "unfair" Chinese currency regime, is causing problems for some Brazilian sectors.

¶14. (SBU) Secretary Paulson indicated that, overall, the U.S. economy is in sound shape. He expects economic expansion to continue, though at a more moderate pace, and believes the most important potential threat to continued U.S. expansion is a rise in inflation that might cause a pre-emptive tightening of the money supply by the Federal Reserve Bank. He felt that recent problems in the sub-prime housing market have bottomed-out, and said he expects the economic impact of sub-prime problems on overall U.S. macroeconomic performance to be well-contained.

¶15. (SBU) Secretary Paulson said he was concerned about three U.S. political issues with a potential negative impact on future economic performance: (1) trade protectionist sentiment; (2) rising income inequality due, in part, to pressures from globalization; and, (3) an inability to develop a political consensus on reforming large entitlement programs (such as health care and social security) that will require larger future USG expenditures.

¶16. (SBU) On U.S.-Brazilian bilateral economic relations, Secretary Paulson highlighted the importance of concluding a treaty between the U.S. and Brazil to eliminate double taxation, since this can create a disincentive for private investment. Secretary Paulson also stated that he favors increased bilateral trade between the U.S. and Brazil, but believes the highest trade policy priority for both countries should be the conclusion of a successful multilateral Doha agreement.

¶17. (SBU) Minister Mantega and Secretary Paulson agreed that the IMF should become more representative of the global economy and should adapt to reflect the growth of countries whose economic importance is increasing. Secretary Paulson noted he will support the candidate the European Union favors to lead the IMF following the departure of Rodrigo de Rato. He told the Minister that Robert

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Zoellick will be a very effective leader of the World Bank, and he is hopeful that the European Union will select someone of comparable stature and qualifications to lead the IMF. Minister Mantega expressed appreciation for Ambassador Zoellick's recent visit to Brazil and for his willingness to reach out to Brazil and other countries before becoming World Bank President.

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